

ST 00-0214-GIL 10/16/2000 CONSTRUCTION CONTRACTORS

Contractors that make improvements to real estate by taking materials off the market and permanently affixing them to real estate in Illinois owe Use Tax on the cost price of those materials. See 86 Ill. Adm. Code 130.1940. (This is a GIL).

October 16, 2000

Dear Mr. Xxxxx:

This letter is in response to your letter dated July 10, 2000. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120 subsections (b) and (c), which can be found at <http://www.revenue.state.il.us/legalinformation/regs/part1200>.

In your letter, you have stated and made inquiry as follows:

I am writing with regards to the applicability of sales taxes on services provided by an S corporation. This particular S corporation is installing computer cables for their clients located within and outside the state of STATE. I need to know if there is a sales tax on the actual service provided. There is no merchandise exchanging hands.

We also need to know if your state has a corporate intangible tax. If so, please send us an Intangible Tax Forms Package with instructions.

Please send us a determination letter as soon as possible.

NEXUS

The following information outlines the principles of nexus. We hope it is helpful to you in determining whether your company is responsible to pay tax in Illinois. An "Illinois Retailer" is one who either accepts purchase orders in the State of Illinois or maintains an inventory in Illinois and fills Illinois orders from that inventory. The Illinois Retailer is then liable for Retailers' Occupation Tax on gross receipts from sales and must collect the corresponding Use Tax incurred by the purchasers. Local taxes may apply. For a list of the current tax rates including local sales taxes that are collected by the Illinois Department of Revenue, please see the Department's Sales Tax Rate Reference Manual that is located on the Department's Web site at www.revenue.state.il.us under the heading, "Tax Information - Sales and Related Taxes and Credits."

If your company does not accept purchase orders in Illinois or maintain an inventory in Illinois and fill Illinois orders from that inventory, your company is not an Illinois retailer. Another type of retailer is the retailer maintaining a place of business in Illinois. The definition of a "retailer

maintaining a place of business in Illinois" is described in 86 Ill. Adm. Code 150.201(i), enclosed. This type of retailer is required to register with the State as an Illinois Use Tax collector. See 86 Ill. Adm. Code 150.801, enclosed. The retailer must collect and remit Use Tax to the State on behalf of the retailer's Illinois customers even though the retailer does not incur any Retailers' Occupation Tax liability. Determining whether a retailer is maintaining a place of business in Illinois is extremely fact specific. The Department cannot make such a complex ruling with the type of limited information that is provided in requests for General Information Letters or Private Letter Rulings.

The United States Supreme Court in *Quill Corp. v. North Dakota*, 112 S.Ct 1904 (1992), set forth the current guidelines for determining what nexus requirements must be met before a person is properly subject to a state's tax laws. The Supreme Court has set out a 2-prong test for nexus. The first prong is whether the Due Process Clause is satisfied. Due process will be satisfied if the person or entity purposely avails itself or himself of the benefits of an economic market in a forum state. *Quill* at 1910.

The second prong of the Supreme Court's nexus test requires that, if due process requirements have been satisfied, the person or entity must have physical presence in the forum state to satisfy the Commerce Clause. A physical presence is not limited to an office or other physical building. Under Illinois law, it also includes the presence of any agent or representative of the seller. The representative need not be a sales representative. Please note that subcontractors in Illinois are generally considered representatives of general contractors for purposes of determining physical presence for tax purposes. Generally, we believe that an out-of-State general contractor utilizing subcontractors in Illinois on at least two or three projects a year would be sufficient to establish a physical presence for nexus purposes and require that general contractor to collect Use Tax on its "over-the-counter" sales in Illinois.

The final type of retailer is the out-of-State retailer that does not have sufficient nexus with Illinois to be required to submit to Illinois tax laws. A retailer in this situation does not incur Retailers' Occupation Tax on sales into Illinois and is not required to collect Use Tax on behalf of its Illinois customers. However, the retailer's Illinois customers will still incur Use Tax on the purchase of the out-of-State goods and have a duty to self-assess their Use Tax liability and remit the amount directly to the State. The Use Tax rate is 6.25%.

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Contractors that make improvements to real estate by taking materials off the market and permanently affixing them to real estate in Illinois owe Use Tax on the cost price of those materials. See the enclosed copies of 86 Ill. Adm. Code 130.1940 and 86 Ill. Adm. Code 130.2075. Those construction contractors do not incur Retailers' Occupation Tax liability when they permanently affix tangible personal property to real estate. If subcontractors are utilized and are acting as construction contractors, the transaction between the general contractors and the subcontractors is not a taxable transaction. The subcontractors incur Use Tax liability on any tangible personal property that they purchase for incorporation into real estate. If, however, general contractors make purchases and

then contract to have subcontractors do the installation, the general contractors incur Use Tax liability because they are making the purchases of such tangible personal property.

It is important to note that since construction contractors are the end users of the materials that they permanently affix to real estate, their customers incur no Use Tax liability and the construction contractors have no legal authority to collect the Use Tax from their customers. However, many construction contractors pass on the amount of their Use Tax liabilities to customers in the form of higher prices or by including provisions in their contracts that require customers to "reimburse" the construction contractor for his or her tax liability. Please note that this reimbursement cannot be billed to a customer as "sales tax," but can be listed on a bill as a reimbursement of tax. The choice of whether a construction contractor requires a tax reimbursement from the customer or merely raises his or her price is a business decision on the construction contractor's part.

Persons from other states who act as construction contractors in Illinois by permanently affixing tangible personal property to real estate owe Illinois Use Tax on the cost price of those materials. The Illinois Use Tax Act contains a credit provision for taxes which were properly due and paid to another state with respect to the purchase or use of tangible personal property in Illinois. See the enclosed copy of 86 Ill. Adm. Code 150.310(a)(3).

If an out-of-State contractor also makes retail ("over-the-counter") sales to Illinois customers without installation, that contractor may be required to register and collect Use Tax (6.25%) on those sales if the contractor has sufficient nexus under the Quill decision described above. Please note again that subcontractors in Illinois are generally considered representatives of general contractors for purposes of determining physical presence for tax purposes. Out-of-State general contractors utilizing subcontractors in Illinois on at least two or three projects a year would generally be sufficient to establish a physical presence for nexus purposes and require that general contractor to collect Use Tax on its "over-the-counter" sales in Illinois.

Please note that persons engaged in making retail sales in Illinois must register and obtain a Certificate of Registration from the Department in order to lawfully sell tangible personal property at retail in this State. See the enclosed copy of 86 Ill. Code 130.701. A "person" is defined in Section 1 of the Retailers' Occupation Act (35 ILCS 120/1) as "[a]ny natural individual, firm, partnership, association, joint stock company, joint adventure, public or private corporation, limited liability company, or a receiver, executor, trustee, guardian or other representative appointed by order of any court." Therefore a corporation (whether subchapter S or not) making retail sales subject to the Retailers' Occupation Tax Act or Use Tax Act must register and file returns.

We do not know what specific tax you are referring to in your letter as a "corporate intangible tax." Generally, there is no sales tax incurred on the transfer of intangibles in this State.

I hope this information is helpful. The Department of Revenue maintains a website, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b) described above.

Very truly yours,

Terry D. Charlton
Associate Counsel

TDC:msk
Enc.